

Laws Prohibiting Tax Deduction of Bribes

In 1996, the OECD Council recommended that those member countries that do not disallow the tax deductibility of bribes to foreign public officials re-examine such treatment with the intention of denying such deductibility (see Appendix B.) This recommendation was reinforced in the Council's 1997 Revised Recommendation on Combating Bribery in International Business Transactions, which laid the foundation for negotiation of the OECD Antibribery Convention. All thirty-four signatories to the Convention have agreed to implement the Council's recommendation on denying the tax deductibility of bribes.

As part of the monitoring process on the Convention and the OECD Council recommendation, the OECD also gathers information on the signatories' laws implementing the recommendation on tax deductibility. Over the past year, the OECD has taken important steps to further the transparency of national legal frameworks dealing with tax deductibility by providing information on current and pending tax legislation in its website (<http://www.oecd.org>). Since 1998, the OECD has posted country-by-country descriptions of the treatment of the tax deductibility of bribes in signatory countries and an up-to-date summary of pending changes to their laws on the tax deductibility of bribes. The information on the website is based entirely on reports that the signatories themselves provide to the OECD secretariat.

The Treasury Department has relied heavily on these OECD sources to prepare the review in Chapter 4 of laws on the tax deductibility of bribes. For some countries, however, non-OECD sources, such as press reports and U.S. embassy reporting, were also used. Generally there was limited information available on how nonmember signatories' tax laws deal with bribery. Even for OECD member countries, information made public by the OECD is not yet comprehensive. We continue to seek additional information on the entire body of signatories' tax and bribery laws so that we will have a better understanding of how the disallowance of tax deductibility will be applied in practice. Our information should improve as the OECD's current monitoring process creates a more complete record of each signatory's legal, regulatory, and administrative framework for disallowing the tax deductibility of bribes and makes that record publicly available. In the meantime, our review of signatories' laws on the tax deduction of bribes must necessarily be of a preliminary nature.

Overall Status of Signatories' Laws Regarding the Tax Deductibility of Bribes

Signatories to the Convention have made substantial progress on the implementation of the OECD Council Recommendation Against the Tax Deductibility of

Bribes, and further progress is expected in the period ahead. According to information made available on the OECD website, only five OECD member countries (Australia, Luxembourg, New Zealand, Sweden, and Switzerland) have reported that they have not yet disallowed these deductions. One of the five, Sweden, enacted a new law on March 25, 1999, under which deductions for bribes to foreign public officials will be disallowed effective on July 1, 1999.

Despite important positive steps taken by signatories, however, such tax deductions are still continuing in some countries. There are several reasons for this. First, some countries have developed legislative proposals to deny the tax deductibility of bribes of foreign public officials, but these proposals either have not been introduced in their legislatures or have not yet received legislative approval. Second, some other countries have changed their tax laws but these laws will not become effective until the date that the Convention enters into force (i.e., sixty days after the deposit of an instrument of ratification with the OECD). Third, grandfather provisions in at least one country's laws may allow tax deductibility to continue. Fourth, it appears that legal frameworks of some countries may only disallow the deductibility of certain types of bribes. Finally, the standard of proof for denying a tax deduction (i.e., the requirement of a conviction for a criminal violation) in some national laws complicates the administration of the tax rules disallowing deductibility.

The purpose of describing the limitations of country laws in the area of the tax deductibility of bribes is to ensure continued focus on improving the situation. Whatever the nature of the legal or administrative loophole that makes it possible to deduct a bribe to a foreign public official, the practice must be eliminated. In his remarks to the Carter Center Conference on May 3, 1999, Treasury Secretary Robert Rubin characterized the fact that some countries have not yet eliminated the tax deductibility of bribes as "simply inexcusable." Monitoring must continue to ensure the full implementation of the OECD Recommendation against the tax deductibility of bribes.

Review of Country Laws on the Tax Deductibility of Bribes

Argentina

Tax deductibility of bribes paid to foreign public officials is not allowed.

Australia

The Australian law outlawing the bribery of foreign public officials was recently passed by both chambers of the legislature. Australia has drafted legislation that would deny deductions (other than minor facilitation payments) for bribery payments made to foreign public officials and also cover bribes paid to nongovernment enterprises associated with foreign governments. This legislation, which would end tax deductibility from July 1, 1999, should be introduced in parliament soon.

Austria

According to legislation passed in late October 1998, bribes paid to foreign public officials are generally no longer deductible for income tax purposes. The Tax Amendment Law of 1998, published in *Bundesgesetzblatt* (Federal Law Gazette) number I/28 of January 12, 1998, amended Section 20, paragraph 1, subparagraph 5 of the Income Tax Act. Under the new legislation, any cash or in-kind remuneration whose granting or receipt is subject to criminal punishment is not deductible from taxable income. The disallowance applies to bribes determined under the Criminal Code, which was amended in August 1998 to extend criminal liability also to bribery of foreign public officials. A deduction may be disallowed before a finding of a criminal violation. However, if no criminal violation is found in a court proceeding, the tax administration may have to allow the tax deduction.

Belgium

A bill aimed at criminalizing bribes to foreign public officials and denying the deductibility of so called "secret commissions" paid in order to obtain or maintain public contracts or administrative authorizations was adopted by the Senate on July 9, 1998, and by the House of Representatives on February 4, 1999. It was published in the Official Journal on March 23, 1999, and entered into force on April 3, 1999. However, the new law does not disallow the deductibility of all bribes to foreign public officials.

Other types of commissions paid to foreign public officials will remain deductible if such commissions: do not exceed reasonable limits; are necessary to compete against foreign competition; and are recognized as a normal customary practice in the relevant country or business sector (i.e., necessary, usual and normal in the given sector). The taxpayer must present a request and disclose to the tax administra-

tion the amount and the purpose of the commissions for the tax administration to decide whether the commission is deductible. If all these conditions are not fulfilled, the deductibility of the commissions is denied, and they are added back to the taxable income of the payer. A tax equal to at least 20.6 percent of the secret commission must be paid whether or not the secret commission is deductible. If the payer is a company, it is liable to a special tax equal to 309 percent of the amount of the bribe.

Brazil

Brazil does not allow tax deductibility of bribes to foreign public officials.

Bulgaria

Bulgarian tax legislation does not allow the deductibility of bribes to foreign public officials. Bribery is a criminal activity under Bulgaria's criminal code. The deduction of bribes in the computation of domestic taxes is not permitted. This disallowance, however, is not explicit in Bulgaria's tax legislation.

Canada

Since 1991, the Income Tax Act has disallowed the deduction as a business expense of payments in connection with a conspiracy in Canada to bribe a foreign public official. Specifically, effective for outlays or expenses after July 13, 1990, Section 67.5 of the Income Tax Act states that any payment that would be an offense identified in several provisions of the criminal code (including bribes and conspiracy to pay bribes to foreign public officials, or persons or companies connected to foreign public officials) is not deductible for income tax purposes. This provision also waives the normal statute of limitations so that an amount may be disallowed any time it is identified no matter how long after it has been paid.

Chile

Chilean tax legislation does not contain specific provisions or rules concerning bribes paid to foreign public officials. Because bribe payments are not considered to be compulsory payments, they are not deductible.

Czech Republic

Czech taxation law and regulations do not allow deductions of bribes paid to foreign public officials. Deductibility is not possible even in cases where the bribe could be treated as a gift. Gifts are deductible

only in exceptional cases under two specific conditions. The gift must be made for one of the following specific purposes: science, education, culture, fire protection or some other social, charitable or humanitarian purposes. The gift must not be over a strictly determined percentage of the tax basis. Only if both conditions are fulfilled can the gift be treated as deductible for tax purposes.

Denmark

The Danish Parliament has adopted a bill proposed by the government denying the deductibility of bribes to foreign public officials. The new legislation came into force on January 1, 1998.

Finland

Finland does not have statutory rules concerning bribes paid to foreign public officials. Similar payments to domestic public officials are nondeductible on the basis of case law and practice of the tax administration. The same rule is expected to apply to bribes paid to foreign public officials in case law. On this basis, the same rule is already being applied in practice by the tax administration regarding bribes to foreign public officials.

France

The French Parliament passed legislation denying the tax deductibility of bribes to foreign public officials on December 29, 1997, pursuant to Article 27 bis of the Corrective Finance Bill for 1997. The law does not allow the deduction of amounts paid or advantages granted directly or through intermediaries to foreign public officials within the meaning of Article 1.4 of the Convention. The tax provision will take effect on July 18, 1999, which is sixty days after the ratification of the Convention by the French National Assembly. The new law applies only to contracts concluded during tax years beginning on or after July 18, 1999.

Germany

Under previous German tax law, deductions or bribes were disallowed only if either the briber or the recipient had been subject to criminal penalties or criminal proceedings which were discontinued on the basis of a discretionary decision by the prosecution. New legislation adopted on March 24, 1999, eliminated these conditions and denied the tax deductibility of bribes. The revised legislation is paragraph 4, Section 5, sentence 1, number 10 of the *Einkommen-*

steuergesetz in the *Steuernlastungsgezet* of March 24, 1999, as published in the *Bundesgesetzblatt* dated March 31, 1999 (BGBl I S. 402).

Greece

Greece does not allow the deductibility of bribes to foreign public officials.

Hungary

Hungary does not allow the deductibility of bribes to foreign public officials since only expenses covered in the tax laws are deductible and the tax laws do not include a specific reference to bribes.

Iceland

Since June 1998, Iceland has not allowed the deductibility of bribes to foreign as well as domestic public officials and officials of international organizations on the basis of law (Section 52 of the Act No. 75/1981 on Tax on Income and Capital as amended by Act No. 95/1998).

Ireland

It is the view of the Irish Revenue Commissioners, on the basis of legal advice received, that bribes paid to foreign public officials are not deductible in principle. These authorities doubt that the conditions for deductibility could ever be met in practice in Ireland. Therefore, Ireland has not considered it necessary to introduce specific legislation to deny a deduction.

Italy

Italy does not allow deductions for bribes paid to foreign public officials. Legislation enacted in 1994 made gains from illicit sources taxable without affecting the nondeductibility of bribes.

Japan

Bribes are treated as an "entertainment expense" under Japanese law; such expenses are not deductible. Japan treats bribes of foreign public officials in the same way as bribes of domestic public officials. Neither is tax deductible.

Korea

Korea does not allow deductions for bribes paid to foreign public officials since they are not considered to be business-related expenses.

Luxembourg

The Minister of Justice and Budget has prepared

draft legislation that would criminalize bribes to foreign public officials as well as deny their tax deductibility. At present, Luxembourg allows deductions for bribes paid to foreign public officials as any business expense.

Mexico

Mexico does not allow the deductibility of bribes to foreign public officials since they would not meet the general requirements to qualify as deductible expenses. Such expenses must be strictly essential for the purposes of the taxpayer's activities and formally documented. Considering that bribes are treated as illicit activities, such payments cannot meet the requirements set forth in the Mexican Commerce Code. Therefore, the payment of a bribe is not a business activity and is not a deductible item.

The Netherlands

A new law, which entered into force as of January 1, 1997, denies the deductibility of expenses in connection with illicit activities if a criminal court has ruled that a criminal offense has been committed. This law will apply to bribes of foreign public officials only when Dutch criminal law is amended to ensure that bribery of foreign public officials is a criminal offense. Until the criminal law incorporating the provisions of the Convention into Dutch law is brought into effect, bribes of foreign government officials will remain deductible.

Under the 1997 law, an income tax deduction is denied for costs connected with a criminal offense for which the taxpayer has been irrevocably convicted by a Dutch criminal judge or has met the conditions of a settlement in lieu of conviction. The period between the deduction of costs connected with a criminal offense on the one hand and the conviction for a criminal offense or a settlement in lieu of conviction on the other hand normally takes several years. The law provides that these deductions will be disallowed and added back to income only if the bribe payment took place within the five years preceding the year of the conviction or of meeting the conditions of the settlement. The bribe payment is added back to income in the year in which the conviction becomes irrevocable or the year in which the conditions of the settlement are met.

New Zealand

Legislation is being prepared to disallow deductions for bribery. At present, deductions are allowed

for bribes paid to foreign officials, provided the recipient is identified.

Norway

Under Section 44, paragraph 1, litra a, subparagraph 5 of the Norwegian Tax Law, which was passed on December 10, 1996, Norway does not allow deductions for bribes paid to foreign private persons or public officials.

Poland

Poland does not allow the deductibility of bribes to foreign public officials. According to Polish law, bribery is illegal and an offense for both the briber and the recipient of the bribe and both are punishable. The provisions of the Corporate Tax Act and Personal Income Tax Act are not applicable to illegal activities. Therefore, gains and expenses connected with the offense of bribery cannot be taken into account by the tax authorities. As a result, the taxpayer is not allowed to deduct them from his income expenses concerning bribes to foreign officials.

Portugal

Portugal does not allow the deductibility of bribes to foreign public officials. On December 20, 1997, Parliament adopted new legislation effective January 1, 1998, to disallow any deduction referring to illegal payments, such as bribes, to foreign public officials.

Slovak Republic

The Slovak Republic does not allow deductions of bribes to foreign public officials or private persons. Bribes are not considered as business-related expenses. Recipients of bribes are liable to criminal prosecution. Expenses related to any bribes are not deductible for taxation purposes.

Spain

Spain does not allow deductions for bribes paid to foreign public officials.

Sweden

A bill explicitly denying the deductibility of bribes and other illicit payments to foreign public officials was presented to the Swedish parliament on December 17, 1998, and was adopted by the Parliament on March 25, 1999. It will become effective on July 1, 1999.

Switzerland

A draft bill on the denial of tax deductibility of

bribes to foreign public officials was submitted in spring 1998 to the cantons and other interested parties for consultation. (Matters of direct taxation are mostly within the competence of the cantons.) This process has been completed, and the revised draft is almost finished. The next step is the submission of the draft bill to Parliament.

There is a longstanding administrative practice under which bribe and commission payments to non-Swiss recipients are considered business expenses, provided that their effective payment and their relationship to the business of the corporate taxpayer is proven.

Turkey

Turkey does not allow deductions for bribes paid to foreign public officials because there is no explicit rule allowing the deductibility of bribes.

United Kingdom

Under Section 577A of the Income and Corporations Tax Act 1988, enacted under the UK Finance Act of 1993, the United Kingdom does not allow deductions for any bribe if that bribe is a criminal offense, contrary to the Prevention of Corruption Acts. The UK has declared that the Prevention of Corruption Acts apply to bribes to foreign public officials. If any part of the offense is committed in the United Kingdom, for example the offer, agreement to pay, the soliciting, the acceptance, or the payment itself, it would be caught by the corruption laws and would then not qualify for tax relief. In addition, UK tax laws also deny relief for all gifts and hospitality given, whether or not for corrupt purposes.

United States

The United States does not allow deductions for bribes paid to foreign government officials if that bribe is a criminal offense. Both before and after the United States criminalized bribery of foreign government officials, it denied tax deductions for such payments. Before the enactment of the Foreign Corrupt Practices Act of 1977, tax deductions were disallowed for payments that were made to an official or employee of a foreign government and that were either unlawful under U.S. law or would be unlawful if U.S. laws were applicable to such official or employee. The denial of the tax deduction did not depend on a conviction in a criminal bribery case. After the United States criminalized bribery of foreign government officials, U.S. tax laws were changed to disallow tax

deductions for payments if made to foreign government officials or employees and if unlawful under the Foreign Corrupt Practices Act of 1977 (FCPA). With respect to U.S. tax provisions for Controlled Foreign Corporations, any payment of a bribe by a foreign subsidiary is treated as taxable income to the U.S. parent. Also, to the extent relevant for U.S. tax purposes, bribes of foreign officials are not permitted to reduce a foreign corporation's earnings and profits. U.S. denial of tax deductibility or reduction of earnings and profits does not depend on whether the person making the payment has been convicted of a criminal offense. On tax deductibility, Treasury has the burden of proving by clear and convincing evidence that a payment is unlawful under the FCPA.